

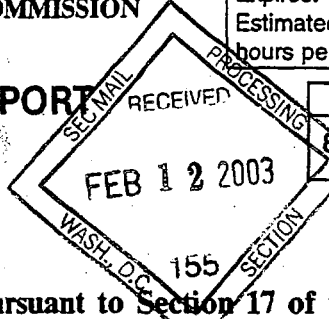
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549



03002768

ANNUAL AUDITED REPORT  
FORM X-17A-5  
PART III



AL 2/4/2003

OMB APPROVAL	
OMB Number:	3235-0123
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FACING PAGE  
Information Required of Brokers and Dealers Pursuant to Section 17 of the  
Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

REPORT FOR THE PERIOD BEGINNING 01/01/02 AND ENDING 12/31/02  
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

Investment Affiliate, Inc.

OFFICIAL USE ONLY

FIRM ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

810 N. Jefferson Street, Suite 101

(No. and Street)

Lewisburg, West Virginia

24901

(City)

(State)

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Drew T. Kagan

(304) 645-2375

(Area Code — Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report\*

Hess, Stewart & Campbell, PLLC

(Name — if individual, state last, first, middle name)

P. O. Box 1060,

Huntington,

West Virginia

25713-1060

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

☒ Certified Public Accountant

☐ Public Accountant

☐ Accountant not resident in United States or any of its possessions.

PROCESSED

MAR 04 2003

FOR OFFICIAL USE ONLY

THOMSON  
FINANCIAL

\*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).

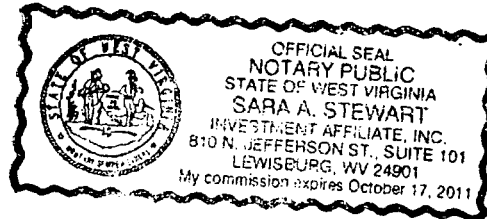
## OATH OR AFFIRMATION

I, Drew T. Kagan, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Investment Affiliate, Inc., as of December 31, 2002, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer, except as follows:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Drew T. Kagan  
Signature  
President / CEO  
Title

Sara A Stewart February 6, 2003  
Notary Public



This report\*\* contains (check all applicable boxes):

- ☒ (a) Facing page.
- ☒ (b) Statement of Financial Condition.
- ☒ (c) Statement of Income (Loss).
- ☒ (d) Statement of ~~Changes in Financial Condition~~ Cash Flow.
- ☒ (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietor's Capital.
- ☒ (f) Statement of ~~Changes in Liabilities Subordinated to Claims of Creditors~~ Comprehensive Income.
- ☒ (g) Computation of Net Capital
- ☒ (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- ☒ (i) Information Relating to the Possession or control Requirements Under Rule 15c3-3.
- /a ☐ (j) A Reconciliation, including appropriate explanation, of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
- ☒ (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- ☒ (l) An Oath or Affirmation.
- /a ☐ (m) A copy of the SIPC Supplemental Report.
- /a ☐ (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.
- X (o) Independent Auditors Report on Internal Accounting Controls.

\*\*For conditions of confidential treatment of certain portions of this filing, see section 240.17a-5(e)(3).

**INVESTMENT AFFILIATE, INC.**

**FINANCIAL STATEMENT**

**AND**

**REQUIRED SUPPLEMENTARY INFORMATION**

**DECEMBER 31, 2002**

INVESTMENT AFFILIATE, INC.

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## Report of Independent Auditors

Board of Directors  
Investment Affiliate, Inc.

We have audited the accompanying statement of financial condition of Investment Affiliate, Inc. (the Company) as of December 31, 2002, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial condition of Investment Affiliate, Inc. as of December 31, 2002, the results of its operations, its cash flows and its changes in stockholders' equity for the year ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information contained in Schedules I and II is presented for purposes of additional analysis and is not a required part of the basic financial statements, but is supplementary information required by rule 17a-5 of the Securities and Exchange Commission. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

HESS, STEWART & CAMPBELL, PLLC

*Hess, Stewart & Campbell, PLLC*

Huntington, West Virginia  
January 31, 2003

MEMBERS

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

**INVESTMENT AFFILIATE, INC.**  
**STATEMENT OF FINANCIAL CONDITION**  
**DECEMBER 31, 2002**

***ASSETS***

Cash and cash equivalents	\$ 204,551
Commissions receivable	47,037
Investments, at cost	15,075
Investments, at fair market value	15,000
Equipment, at cost less accumulated depreciation of \$17,875	8,557
Deposits with clearing broker and others	<u>65,166</u>

***TOTAL ASSETS*** **\$ 355,386**

***LIABILITIES AND STOCKHOLDERS' EQUITY***

***LIABILITIES***

Accrued expenses and other liabilities	\$ 7,881
Accrued payroll and payroll taxes	793
Accrued other taxes	<u>2,361</u>

***TOTAL LIABILITIES*** **\$ 11,035**

***STOCKHOLDERS' EQUITY***

Common stock, par value \$1 per share -- 100 shares authorized, issued and outstanding	100
Additional paid-in capital	54,528
Unrealized gain (loss)	(9,525)
Retained earnings	<u>299,248</u>

***TOTAL STOCKHOLDERS' EQUITY*** **344,351**

***TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY*** **\$ 355,386**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

**INVESTMENT AFFILIATE, INC.**  
**STATEMENT OF INCOME**  
**YEAR ENDED DECEMBER 31, 2002**

**REVENUES**

Commissions - equities	\$ 62,656
Commissions - mutual funds	151,717
Commissions - annuities	3,739
Commissions - other	1,328
Revenue - transaction fees	246,055
Revenue - advisory fees	274,146
Other income	1,229
Interest income	<u>77,071</u>

**TOTAL REVENUES** \$ 817,941

**COST OF SALES**

Commissions - Brokers	7,695
Clearing costs	115,690
Telephone and communications	8,516
Other	<u>175</u>

**TOTAL COST OF SALES** 132,076

**GROSS PROFIT** 685,865

**OPERATING EXPENSES**

Professional services	35,504
Wages and salaries	142,553
Payroll taxes	9,253
Other operating expenses	<u>87,963</u>

**TOTAL OPERATING EXPENSES** 275,273

**NET INCOME** \$ 410,593

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

**INVESTMENT AFFILIATE, INC.**  
**STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY**  
**YEAR ENDED DECEMBER 31, 2002**

	<b>Common <u>Stock</u></b>	<b>Additional Paid-In <u>Capital</u></b>	<b>Unrealized <u>Gain (loss)</u></b>	<b>Retained <u>Earnings</u></b>	<b><u>Total</u></b>
Balance, 01/01/02 \$	100	\$ 54,528	\$ 0	\$ 263,655	\$ 318,283
Net income	0	0	0	410,593	410,593
Unrealized loss	0	0	(9,525)	0	(9,525)
Distributions	<u>0</u>	<u>0</u>	<u>0</u>	<u>(375,000)</u>	<u>(375,000)</u>
Balance, 12/31/02 \$	<u>100</u>	<u>\$ 54,528</u>	<u>\$ (9,525)</u>	<u>\$ 299,248</u>	<u>\$ 344,351</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS



**INVESTMENT AFFILIATE, INC.**  
**STATEMENT OF COMPREHENSIVE INCOME**  
**DECEMBER 31, 2002**

<i>NET INCOME</i>	\$ 410,593
<i>OTHER COMPREHENSIVE INCOME</i>	
Unrealized holding losses	<u>(9,525)</u>
<i>COMPREHENSIVE INCOME</i>	<u>\$ 401,068</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

**INVESTMENT AFFILIATE, INC.**  
**STATEMENT OF CASH FLOWS**  
**YEAR ENDED DECEMBER 31, 2002**

***OPERATING ACTIVITIES***

Net income	\$ 410,593
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation	3,765
Change in operating assets and liabilities:	
Decrease in commissions receivable	11,449
Increase in deposits and other assets	(49,300)
Decrease in accrued expenses	(8,793)
Increase in accrued payroll and payroll taxes	746
Decrease in accrued other taxes	<u>(595)</u>

***NET CASH PROVIDED BY OPERATING ACTIVITIES***                     \$ 367,865

***INVESTING ACTIVITIES***

Securities purchased	(19,500)
Purchase of equipment	<u>(145)</u>

***NET CASH USED IN INVESTING ACTIVITIES***                     (19,645)

***FINANCING ACTIVITIES***

Distribution to stockholders	<u>(375,000)</u>
------------------------------	------------------

***NET CASH USED IN FINANCING ACTIVITIES***                     (375,000)

***DECREASE IN CASH***                     (26,780)

***CASH AND CASH EQUIVALENTS, beginning of year***                     231,331

***CASH AND CASH EQUIVALENTS, end of year***                     \$ 204,551

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION**

**UNREALIZED LOSS ON INVESTMENTS**                     \$ (9,525)

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

**INVESTMENT AFFILIATE, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2002**

***Note 1 - Organization and Nature of Business***

The Company is a broker-dealer registered with the Securities and Exchange Commission (SEC) and is a member of the National Association of Securities Dealers (NASD). The Company is an introducing broker using a clearing broker to clear trades and maintain customer accounts.

***Note 2 - Significant Accounting Policies***

***Basis of Accounting***

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. The following is a summary of the more significant accounting and reporting policies.

***Cash and Cash Equivalents***

Cash and cash equivalents, recorded at cost, which approximates market value, is comprised of cash held in a bank account and funds maintained in a cash management account.

***Equipment***

Equipment is stated at cost less accumulated depreciation. Depreciation was determined using straight-line depreciation over the estimated useful lives of the assets, generally 60 months. Depreciation expense was \$3,765 in 2002.

***Income Taxes***

Effective for the year ended December 31, 1998, the company, with the consent of its stockholders, has elected under the Internal Revenue Code to be an S Corporation. In lieu of corporation income taxes the stockholders of an S corporation are taxed on their proportionate share of the company's taxable income. Therefore, no provision or liability for federal income taxes has been included in the financial statements.

***Investments***

Stock warrants with no readily determinable market value are carried at original cost. All other investments are carried at published market values.

**INVESTMENT AFFILIATE, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2002**

***Note 3 - Receivable From and Payable to Broker-Dealers and Clearing Organizations***

Amounts receivable from and payable to broker-dealers and clearing organizations at December 31, 2002, consist of the following:

	<u>Receivable</u>	<u>Payable</u>
Payable to clearing broker	\$ -0-	\$ -0-
Receivable from clearing organizations	33,198	-0-
Fees and commissions receivable/payable	<u>13,839</u>	<u>-0-</u>
	\$ <u>47,037</u>	\$ <u>-0-</u>

The Company clears all its transactions through other broker-dealers on a fully disclosed basis. Amounts payable to the clearing broker are collateralized by a \$65,000 deposit on hand with the clearing brokers.

***Note 4 - Line of Credit***

The Company has a \$200,000 line of credit available with a financial institution. The line of credit bears interest at the prime interest rate, and is secured by the business assets. At December 31, 2002 no amount was borrowed against this line.

***Note 5 - Investments***

At December 31, 2002, the Company's investments consisted of stock warrants that provide the right to purchase shares of a non-publicly traded company. These warrants become exercisable at various future dates and are carried at cost since they have no readily determinable market value. The warrants have restrictions as to transferability and it is the Company's intention to hold them until at least the exercise date. Other investments consist of equities carried at fair market value.

***Note 6 - Leases***

The Company leases its office facilities under a noncancelable lease that expires in September, 2003 and includes a monthly rental payment of \$1,000. The Company has the option to renew the lease for two additional two-year terms that each include a 7% increase in rent. Lease expense for the year on this lease was \$12,000.

**INVESTMENT AFFILIATE, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2002**

***Note 7 - Concentrations of Credit Risk***

The Company is engaged in various trading and brokerage activities in which counterparties primarily include broker-dealers, banks and other financial institutions. In the event counterparties do not fulfill their obligations, the Company may be exposed to risk. The risk of default depends on the creditworthiness of the counterparty or issuer of the instrument. It is the Company's policy to review, as necessary, the credit standing of each counterparty.

***Note 8 - Net Capital Requirements***

The Company is subject to the Securities and Exchange Commission Uniform Net Capital Rule (SEC rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. At December 31, 2002, the Company had net capital of \$302,206, which was \$297,206 in excess of its required net capital of \$5,000. The Company's net capital ratio was .036 to 1.

***Note 9 - Statement of Changes In Liabilities Subordinated to Claims of General Creditors***

As of December 31, 2002, the Company had no liabilities subordinated to claims of general creditors. Accordingly, a Statement of Changes In Liabilities Subordinated to Claims of General Creditors is not included.

**INVESTMENT AFFILIATE, INC.**  
**SCHEDULE I - COMPUTATION OF NET CAPITAL UNDER**  
**RULE 15c3-1 OF THE SECURITIES AND EXCHANGE COMMISSION**  
**DECEMBER 31, 2002**

***NET CAPITAL***

Total stockholder's equity qualified for net capital		\$ 344,351
Deduction for non-allowable assets:		
Equipment, less accumulated depreciation of \$17,875	\$ 8,557	
Investments	30,075	
Deposits	<u>166</u>	
		<u>38,798</u>
<i>Net capital before haircuts on securities positions</i> <i>(tentative net capital)</i>		305,553
Haircuts on money market		<u>3,347</u>
<i>Net capital</i>		<u><u>\$ 302,206</u></u>

***AGGREGATE INDEBTEDNESS***

Items included in statement of financial condition:		
Accrued expenses and other liabilities	\$ 7,881	
Accrued payroll and payroll taxes	793	
Accrued other taxes	<u>2,361</u>	
<i>Total aggregate indebtedness</i>		<u><u>\$ 11,035</u></u>

***COMPUTATION OF BASIC NET CAPITAL REQUIREMENT***

Minimum net capital required based on aggregate indebtedness	<u><u>\$ 736</u></u>
Minimum dollar requirement	<u><u>\$ 5,000</u></u>
Net capital requirement	<u><u>\$ 5,000</u></u>
Excess net capital	<u><u>\$ 297,206</u></u>
Excess net capital at 1,000%	<u><u>\$ 301,102</u></u>
Ratio: Aggregate indebtedness to net capital	<u><u>.036 to 1</u></u>

**INVESTMENT AFFILIATE, INC.**  
**SCHEDULE I - COMPUTATION OF NET CAPITAL UNDER**  
**RULE 15c3-1 OF THE SECURITIES AND EXCHANGE COMMISSION**  
**DECEMBER 31, 2002**

***RECONCILIATION WITH COMPANY'S COMPUTATION (INCLUDED IN***  
***PART II FORM X-17A-5 AS OF DECEMBER 31, 2001)***

<i>Net capital, as reported in Company's</i> <i>Part II (unaudited) FOCUS report</i>	\$ 297,194
Audit adjustment to:	
Accrue commissions receivable	13,840
Accrue interest income	33
Adjust accrued expenses	<u>(8,861)</u>
<i>Net capital per above</i>	\$ <u><u>302,206</u></u>

**INVESTMENT AFFILIATE, INC.**  
**SCHEDULE II – COMPUTATION FOR DETERMINATION OF RESERVE**  
**REQUIREMENTS AND INFORMATION RELATING TO POSSESSION OR**  
**CONTROL REQUIREMENTS PURSUANT TO RULE 15C3-3 OF THE**  
**SECURITIES AND EXCHANGE COMMISSION**  
**DECEMBER 31, 2002**

Investment Affiliate, Inc. is not required to present the schedules "Computation for Determination of Reserve Requirements Under Rule 15c-3" and "Information for Possession or Control Requirement relating to Rule 15c3-3" as it meets the exemptive provisions of Rule 15c3-3, under Section 15c3-3(k)(2)(B) of the Rule.



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DARRELL D. TUCKER, CPA

## Report of Independent Auditors on Internal Accounting Control Required by Sec Rule 17a-5

Board of Directors  
Investment Affiliate, Inc.

In planning and performing our audit of the financial statements and supplemental schedules of Investment Affiliate, Inc. for the year ended December 31, 2002, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control structure.

Also, as required by Rule 17a-5(g)(1) of the Securities and Exchange Commission(SEC), we have made a study of the practices and procedures (including test of compliance with such practices and procedures) followed by the Company that we considered relevant to the objectives stated in rule 17a-5(g) in making the periodic computations of aggregate indebtedness and net capital under rule 17a-3(a)(11) and the procedures for determining compliance with the exemptive provisions of rule 15c3-3. The Company was in compliance with the conditions of the exemption and no facts came to our attention indicating that such conditions had not been complied with during the period. We did not review the practices and procedures followed by the Company in making the quarterly securities examinations, counts, verifications and comparison, and the recordation of differences required by rule 17a-13 or in complying with the requirements for prompt payment for securities under Section 8 of Regulation T of the Board of Governors of the Federal Reserve System, because the Company does not carry security accounts for customers or perform custodial functions relating to customer securities.

The management of the Company is responsible for establishing and maintaining an internal control structure and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures and of the practices and procedures referred to in the preceding paragraph and to assess whether those practices and procedures can be expected to achieve the SEC's above-mentioned objectives. Two of the objectives of an internal control structure and the practices and procedures are to provide management with reasonable, but not absolute, assurance that assets for which the Company has responsibility are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit preparation of financial statements in conformity with generally accepted accounting principles. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in any internal control structure or the practices and procedures referred to above, errors or irregularities may occur and not be detected. Also, projection of any evaluation of them to future periods is subject to the risk that they may become inadequate because of changes in conditions or that the effectiveness of their design and operation may deteriorate.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control structure that we consider to be material weaknesses as defined above.

We understand that practices and procedures that accomplish the objectives referred to in the second paragraph of this report are considered by the SEC to be adequate for its purposes in accordance with the Securities and Exchange Act of 1934 and related regulations, and that practices and procedures that do not accomplish such objectives in all material respects indicate a material inadequacy for such purposes. Based on this understanding and on our study, we believe that the Company's practices and procedures were adequate at December 31, 2002 to meet the Commission's objectives.

This report is intended solely for the use of management, the Securities and Exchange Commission, The National Association of Securities Dealers, Inc. and other regulatory agencies which rely on Rule 17a-5(g) under the Securities and Exchange Act of 1934 and should not be used for any other purpose.

**HESS, STEWART & CAMPBELL, PLLC**

*Hess, Stewart & Campbell, PLLC*

Huntington, West Virginia  
January 31, 2003